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**THE MICHIGAN DEPARTMENT  
OF ENVIRONMENTAL QUALITY**

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**THE MICHIGAN MUNICIPAL BOND AUTHORITY**

Janet Hunter-Moore, Executive Director

Under the Authority of Part 53, Clean Water Assistance, of the Natural Resources  
and Environmental Protection Act, 1994 PA 451 and the Shared Credit Ratings Act, 1985 PA 227

**Present the**

**FISCAL YEAR 1999 ANNUAL REPORT  
of the MICHIGAN STATE REVOLVING FUND**

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## **I. INTRODUCTION**

This Fiscal Year (FY) 1999 Annual Report is submitted to the United States Environmental Protection Agency (EPA) in compliance with Sec. 602(b)(10) and Sec. 606(d) of the Federal Water Pollution Control Act, P.L.92-500, as amended. It covers the period from October 1, 1998 to September 30, 1999, highlighting the activities of Michigan's State Revolving Fund (SRF) loan program.

The Michigan Department of Environmental Quality (MDEQ) is the lead agency for this program. The Municipal Facilities Section (MFS) of the Environmental Assistance Division (EAD) continues to serve as the MDEQ's program administrators for the SRF.

The MDEQ and the Michigan Municipal Bond Authority (MMBA) jointly administer this program under the authority of Part 53, Clean Water Assistance, of the Natural Resources and Environmental Protection Act, 1994 PA 451, and 1985 PA 227, the Shared Credit Ratings Act, as amended. The state also conducts its SRF in a manner consistent with requirements established in the federal Water Pollution Control Act (P.L.92-500, as amended) and federal regulation.

We offer this comprehensive public report to detail the activities undertaken to reach the objectives set forth in the final FY1999 Intended Use Plan (IUP). This annual report is submitted to EPA and is available as a read-only file through the MFS Home Page found in the World Wide Web on Internet. The Internet address is <http://www.deq.state.mi.us/ead/mfs>.

## **II. CAPITALIZATION OF THE SRF**

During FY1999, Michigan received a federal grant of \$65,654,797 on May 12, 1999. The state is required to provide a 20 percent match for each federal dollar contributed to capitalize the SRF. To match the FY1999 federal grant, Michigan provided \$13,130,959. The source of this match was derived from state general fund appropriations and state match bonds. In addition to the federal and state capital contributions, the SRF is also capitalized with principal and interest payments from earlier loans and from released funds from debt service reserve accounts. Please note that the federal capitalization grant accounts for only 42 percent of the total capital funds for Michigan's SRF. Thus, for FY1999, the total capitalization of the SRF was \$154,219,830. The breakdown is as follows:

Title VI Fund	\$57,904,704
Sec 205(m) Transfers	\$ 7,750,093
State Match	\$13,130,959
Principal Repayment	\$28,697,397
MMBA	
Interest Repayment	\$12,517,414
Investment Earnings	\$34,519,263

Note: Above does not include FY1998 carryovers or released funds.

## **III. PROGRAM ISSUES**

Binding commitments made during FY1999 were awarded with an interest rate of 2.5 percent. Repayments are amortized over 20 years with approximately level debt service. There were no loan guarantees or project refinancings provided during FY1999. All commitments were made to qualified Section 212 projects.

For FY1999, projects for qualified Section 212 uses were drawn from the FY1999 Project Priority List administered under provisions set forth in Part 53, Clean Water Assistance, of the Natural Resources and

Environmental Protection Act, 1994 PA 451, and its accompanying administrative rules. A copy of this list was submitted to the EPA prior to the start of FY1999.

The MDEQ continues to promote the SRF in local community meetings, through continued dissemination of the SRF brochure and guidance documents, through The Loan Arranger, through the MFS website, and through participation in various public forums. Staff has at its disposal, a computerized presentation in Microsoft Powerpoint explaining the SRF. This presentation is targeted toward local community groups and can be tailored to a specific audience by adding, deleting, or editing the slides. The presentation is available in three separate media; slides, overheads, and a diskette and is also available for download through the EAD website.

#### **IV. GOALS AND ACCOMPLISHMENTS**

##### **A. Short-Term Goals and Accomplishments**

Michigan's IUP described short-term goals to be implemented during FY1999. They were:

**1. To continue on-going revisions to the SRF Procedures Manual.**

This is a continual process involving staff and management effort to review and redraft chapters to reflect changes in the operational procedures of managing the SRF.

**2. Establish a Small Community Hardship Assistance Program.**

Michigan has continued to look for opportunities to provide assistance to small communities in hardship situations. One of the stumbling blocks to implementation of any type of hardship assistance program to accommodate the available federal money is that most communities in Michigan are already sewered. The existing federal funds are targeted towards unsewered communities and are too restrictive for Michigan's existing situation. Michigan will continue to explore possibilities to assist small communities experiencing economic difficulties.

**3. To fund those projects identified in the Intended Use Plan.**

In the first quarter, one project was funded at \$10,935,000. In the second quarter, three projects were funded totaling \$30,375,000, and ten projects were funded in the third and fourth quarter totaling \$46,005,000 and \$155,680,000 respectively. For the full fiscal year, the MDEQ and the MMBA committed \$249,995,000 to 17 projects, bringing the total commitments made from inception of the SRF to \$1.076 billion. A "Billion Dollar Celebration" for Michigan's SRF was held in November 1999. Closings have taken place on 165 projects during the life of the SRF to date.

**4. Work with other agencies in developing integrated approaches to watershed management.**

Other than those activities described in Section IV, B, 1, no further activity is occurring in this area.

**5. Coordinate disbursement practices with the DEQ's Office of Financial Services.**

Work continues in coordinating/streamlining and improving disbursement practices. One area being explored is electronic processing of disbursements between the MDEQ and MMBA. Further improvements will be available when the MMBA initiates operation of its data management system.

**B. Long-Term Goals and Accomplishments**

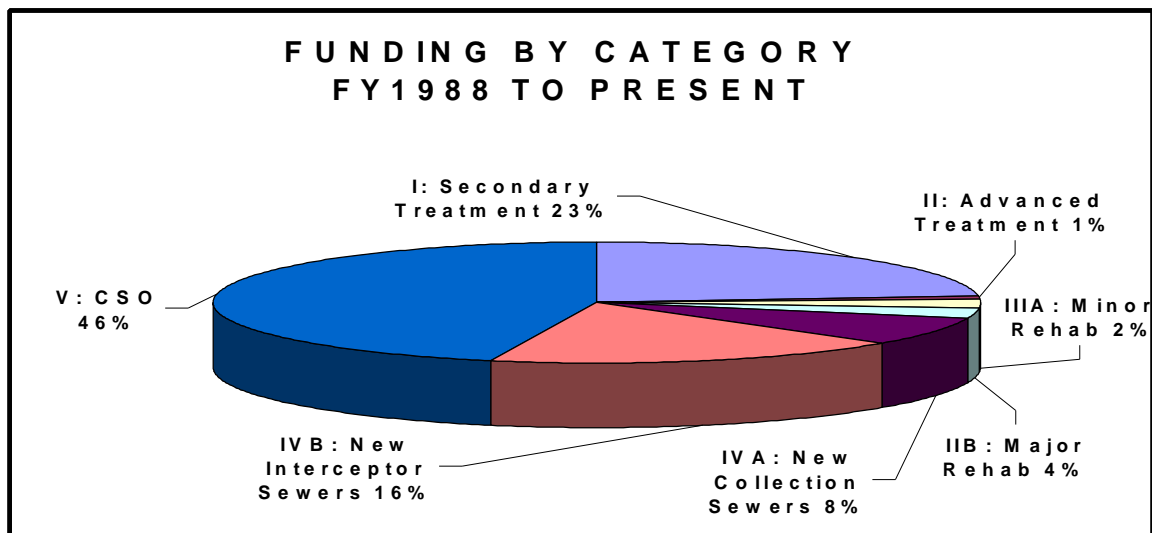
Michigan's IUP also included long-term goals that would be addressed by the SRF. They were:

**1. To achieve and maintain statewide compliance with all applicable State and Federal laws, rules, and standards.**

The SRF is a major inducement for local municipalities to cooperate and voluntarily seek to achieve compliance with state and federal laws and water quality standards.

The MDEQ maintains a core belief that achievement of pollution prevention is far more effective if potential projects are examined to ensure compliance with water quality standards, while also meeting criteria to establish the solution as the cost-effective alternative in order to protect the viability of the SRF.

In past years, Michigan's SRF program has provided substantial assistance in funding towards combined sewer overflow (CSO) abatement efforts. The state has funded sizable projects in Grand Rapids, Lansing, and Saginaw. While over the life of the SRF, 46 cents of every dollar loaned has been used for correction of CSO problems, there is still work to finish. The SRF will continue to fund necessary CSO projects as they arise and anticipated Phase II Rouge River projects, as well as those from the city of Detroit, over the next few years. Following is a chart displaying the types of projects funded by the SRF. Chart 1 is a detailed list of projects funded by category.



**2. To protect the public health and environmental quality of our state.**

Inherent within the SRF program is our resolve to first protect the public's health and welfare. Our priority system is structured to give greatest weight to problems that most impact the health of Michigan's citizens and the environmental integrity of our state.

The state's Project Priority List establishes the list of fundable projects for each fiscal year. Projects are ranked using a number of criteria including outstanding enforcement action against proposed applicants. Michigan places a high priority on resolving those situations where enforcement action is involved and, accordingly, any enforcement action against a community plays a crucial role in establishing that community's position in the fundable range. Many of the projects at the top of the fundable range are involved in an enforcement action of some type.

**3. To further integrate principles of watershed management and water quality restoration within urban as well as outstate areas.**

One of the MDEQ's major initiatives is the redevelopment of urban brownfield areas in hopes of preventing the continued degradation of open farmlands. Whenever an urban project has scored high enough in priority, the SRF has sought to provide financial assistance to improve the water quality of the project area.

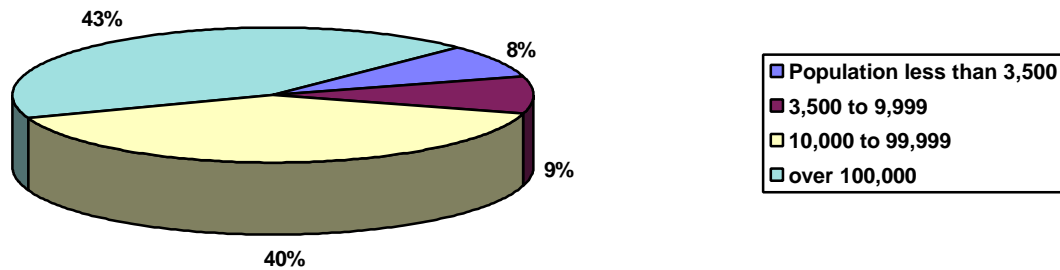
We have already sought to incorporate the watershed sensitivity into our project management. A good example is the commitments to Lansing, East Lansing, Grand Ledge, and Grand Rapids for their CSO strategies that reduce pollutant loadings in the Grand River watershed. Our continuing efforts to work with communities in the Rouge River watershed in addressing their needs also reflects our commitment to watershed management.

While the SRF has funded substantial projects in outstate Michigan, it has contributed substantial assistance to urban communities such as Lansing, Grand Rapids, Detroit, Wayne County, Saginaw, and communities tributary to Lake St. Clair, to address major needs within each. Of the total SRF loan dollars distributed to date, 42 percent has been awarded to projects with service areas in excess of 100,000 population.

The accompanying charts document the progress made since the inception of the program. Michigan's commitment to small communities remains equally strong. Of the 17 projects funded this year, 4 projects representing \$15,295,000 in construction costs were for communities with populations less than 10,000. Over the life of the SRF, a total of 62 loans, or 17 percent of loans made, were issued to communities with population less than 10,000. In dollar volume, almost \$185 million, or 17 percent of total binding commitments went to these smaller communities. To date, the numerical distribution of SRF loans is as follows:

Population less than 3,500	\$ 88,805,000
3,500 to 9,999	\$ 97,420,000
10,000 to 99,999	\$ 420,645,000
<u>over 100,000</u>	<u>\$ 462,450,000</u>
TOTAL LOANS	\$1,076,800,000

**Number of Projects Sorted by Population**



4. **To secure Michigan's full share of federal funding available under Title VI and to expeditiously obligate these moneys, along with state contributions, for the construction of water pollution control activities that meet state and federal requirements.**

The SRF has applied for and received all available capitalization grants through FY1999's federal appropriation. These funds are being committed to local units of government in an expeditious manner. In addition, the released moneys generated from satisfaction of the debt service default tolerances were also made available for loan commitment within the fiscal year following release. Michigan's reliance on federal capitalization grants has now diminished to the point that the federal contribution to the SRF represents only 27 percent of the total amount available for loans.

5. **To maintain an effective program of community environmental education, outreach, and involvement within watersheds.**

The MFS continues to expand the amount of information available through its homepage and makes available all pertinent documents for public viewing. In addition, all documents have been converted into the PDF format for easier downloading by interested internet users. The MFS also puts out an informational newsletter three times a year entitled *The Loan Arranger*.

6. **To ensure that the pace of the SRF program satisfies EPA requirements.**

Michigan continues to meet program pace expectations. In FY1999 all available funds were committed to loans.

## **V. DETAILS OF ACCOMPLISHMENTS**

### **A. Fund Financial Status**

1. **Binding Commitments:** The SRF made 17 binding commitments to Section 212 projects during the fiscal year. The state's commitments are made in the form of Orders of Approval issued by the Chief of the EAD on behalf of the MDEQ.

Chart 2 (Funded SRF Projects to Date) provides a complete, chronological list of all projects assisted by the SRF to date.

During FY1999, \$242,995,000 was committed for project assistance. The total cumulative binding commitments to communities equal \$1.076 billion as of September 30, 1999.

2. Capitalization Grants: The Michigan Water Pollution Control Revolving Loan Fund was awarded a capitalization grant of \$65,654,797 from FY1999 federal funds. This amount was matched by the state with a \$13,130,959 contribution from general funds and state match bonds. Loans were awarded from these funds, the remaining uncommitted balances from earlier awards, and from investment earnings and repayments from earlier loans.
3. Other Revenue: In addition to the capital provided by the EPA and the state, principal repayments of \$28,697,397 and interest repayments of \$12,517,414 were made to the SRF by local borrowers of earlier fiscal year funds. Other sources of investment income totaling \$34,519,263, were also generated from fund holdings and will be identified in the MMBA financial reports.
4. Disbursements: Additional disbursements of \$131,555,316 were made during FY1999, bringing the total during the program's life to \$778,790,853. This means Michigan's SRF has dispersed 72 percent of the project commitments to date. Administrative expenses accrued in FY1999 were \$1,397,824.
5. Audit Report: An audit of MMBA's financial records for the SRF will be forwarded upon completion in the near future. Unaudited financial records will be sent under separate cover from the MMBA.

The audit concluded by Plant and Moran during FY1999 found that the SRF program reporting procedures were in compliance with Generally Accepted Accounting Principles, and also encompassed Generally Accepted Governmental Accounting Standards. The audit was received on January 7, 2000 and will be transmitted to the EPA under separate cover.

We believe these financial statements reflect the condition of Michigan's SRF and underscore the sound management necessary to ensure the health of the fund in relation to its goals and objectives. This state has fulfilled requirements found at 40 CFR 3135(h) by establishing fiscal controls and accounting procedures to assure proper accounting for payments received by the SRF, disbursements made by the SRF, and SRF balances.

6. Credit Risk of the SRF: Michigan undertakes an exhaustive review of each applicant's credit-worthiness. This review examines the financial health of the community and its primary commercial and industrial base. The resulting approval of each applicant provides a sound basis for awarding assistance to only those communities possessing the ability to repay the loan.

No assistance is offered to any community that is unable to demonstrate an investment grade rating. If a community cannot demonstrate a minimum investment grade rating, we expect them to seek credit enhancement or finance through another governmental agency (such as the county). This must be done in order to secure their credit position before the Order of Approval can be written. Michigan's SRF has never suffered a payment default from any municipality.



B. Assistance Activity

Loan assistance through the MMBA was awarded to each of the municipalities that received an Order of Approval from the MDEQ. No other qualified uses of the funds were made other than project and administrative funding.

C. Provisions of the Operating Agreement/Conditions of the Grant

The state of Michigan agreed to a number of conditions in the Operating and/or Capitalization Grant Agreement. These conditions are described below:

1. Provide a State Match: The Michigan Legislature appropriated the amount necessary for the 20 percent FY1999 state match. In addition, Michigan has sold state match revenue bonds to make up the balance not appropriated. In the past, the match was held in a state common cash fund administered by the Michigan Department of Treasury. For FY1999, however, the amount from the state General Fund was deposited in full to the SRF accounts. The MMBA now administers the match accounts as part of their overall financial management.
2. Binding Commitments: The state entered into 17 binding commitments to provide assistance from the SRF to local municipalities. By the act of offering these commitments during FY1999, Michigan continues to exceed the requirement for award of 120 percent of the payment amount within one year.

Additionally, we account for \$1,397,824 in actual administrative expenses, which are also applied against the state's binding commitment requirement. The EPA allows the State to account for the full 4 percent of the federal capitalization grants to be applied against binding commitments at the time of each grant award. Michigan has chosen to account only for actual administrative expenses against binding commitments for programmatic reasons.

3. Expeditious and Timely Expenditure of Available Funds: The EPA annually reviews the reimbursement process used by the MDEQ and the MMBA to ensure that payments to municipalities are made in a timely and expeditious manner. In most instances, a wire transfer occurs within ten days of receipt of a request for reimbursement from the local unit of government. The EPA on-site visits have affirmed Michigan's sustained ability to turn payment requests around quickly. The local communities and the contractors know that we will expeditiously handle this important task, ensuring no delays in the flow of funds to the project. Documents upon which this assessment is based are available for inspection at the MDEQ and the MMBA offices, and are included in the SRF database.

The federal share is provided through the federal Automated Clearinghouse. State funds are drawn simultaneously with the federal funds during this time. The state portion is drawn through the treasury inter-accounting system. The draw method used in Michigan satisfies our state requirements to provide a state match prior to, or at the time of, the federal draw on the Automated Clearinghouse system.

To date, Michigan's SRF has committed \$1.076 billion in project loans. Administrative expenses, which EPA also counts toward binding commitments equal \$28,818,597 assuming 4 percent of all federal capitalization grants to date. Accounting for the reserve requirement for bonds sold, Michigan is ensuring expeditious commitment of the available money in the SRF to local municipal projects.

4. Amendments to the IUP: The final IUP and Project Priority List for FY1999 were submitted to the EPA at the end of 1999.
5. Minority and Women's Business Enterprises: In order to meet federal initiatives, the state of Michigan agreed to an overall fair-share objective for FY1999 of 4 percent for Minority Business Enterprise (MBE) and 4 percent for Women's Business Enterprise (WBE). In its attempt to meet this objective, the state advised all potential applicants for SRF loans of this commitment. In addition, the state included a reporting requirement as a special condition in all supplemental agreements executed between the loan recipient, the MDEQ, and the MMBA.

As part of the state's continuing effort to meet the MBE/WBE objective, presentations are made at the pre-bid meetings to explain the federal requirements to potential contractors, subcontractors, and suppliers.

Compliance with the loanee's reporting requirements has shown that the state of Michigan has exceeded its MBE objective for FY1999 by reaching an actual participation of 18 percent for MBEs and 12 percent for WBEs. These figures were reported to Ms. Karen Jurgensen, Office of Financial Services, MDEQ, as part of the state's required submission during the fourth quarter of FY1999.

6. Other Federal Authorities: The state of Michigan requires each municipality to comply with all applicable federal crosscutting authorities and stipulates that the authorized representative so certify in the application. The Application for Assistance sets forth municipal requirements for compliance with federal cross-cutters.

We seek up-front coordination by involving a wide range of agencies in the Finding of No Significant Impact (FNSI) process during drafting of the Environmental Assessment. These federal, state, and local agencies are given the chance to add input to the project and comment on any crosscutting issues.

Environmental cross-cutters are typically addressed during review and approval of a project plan. Activities conducted by MDEQ staff are presented in the Project Planning/ Environmental Assessment chapter of our SRF procedures manual.

Cross-cutting issues relating to social legislation are dealt with prior to the loan award through applicant certifications mentioned earlier and through follow-up reporting, such as in the case of MBE/WBE requirements.

Our staff procedures manual outlines the appropriate response in the event cross-cutting issues arise. When warranted, we coordinate contacts with appropriate agencies. If necessary, the state will seek assistance from the EPA for help with non-agency federal offices.

7. State Environmental Review Process: The 17 communities receiving assistance during FY1999 were reviewed and approved using the state's environmental review procedures. It was determined that no Environmental Impact Statements were necessary, instead an Environmental Assessment was prepared and a FNSI was issued for each project.
8. Consistency with Planning: No project plan in the state of Michigan can be approved without sign-off from the appropriate 208 planning agency, which documents the submittal is consistent with regional planning. Assurance of this review is inherent within each and every plan we approve.

Section 205(j) and 303(e) requirements are administered separately from the SRF by various sections of the MDEQ Surface Water Quality Division. Grants have been made to several local and regional entities to carry out water quality management planning. Sec. 303(e) requirements are satisfied via our state permitting process. In order to continue Michigan's delegated permit writing program, the state must comply with Section 303(e). Prior to receiving the first capitalization grant, this office verified the existence of an approved planning process. The EPA's continued recognition of our delegation is proof that we remain in compliance.

9. Cash Disbursements: Procedures are executed in conjunction with the MMBA. The MDEQ receives requests for disbursements from the local municipalities. We review them for content and accuracy and then transmit them simultaneously to the MMBA and the MDEQ's Office of Financial Services. The respective offices will process a request for a state match transfer into the SRF and process a request to draw on the federal Automated Clearinghouse system in accordance with 40 CFR 35.3135(b)(1). Once in the SRF account, the MMBA processes a wire transfer of funds to the local municipality.
10. Administration of the SRF: The MDEQ has agreed to administer the SRF in accordance with its application, IUP and the Operating Agreement. In doing so, certain administrative procedures are implicit. The operation of the fund is bound by the following provisions:
  - agreement to accept payments
  - state laws, rules, and procedures
  - state accounting and auditing procedures
  - recipient accounting and auditing procedures
  - use of the Automated Clearinghouse federal payment system
  - repayment
  - annual audit requirements
  - annual report
  - annual review

To the extent of any conflict amongst these documents, the MDEQ further agreed that terms of the Grant Agreement will prevail.

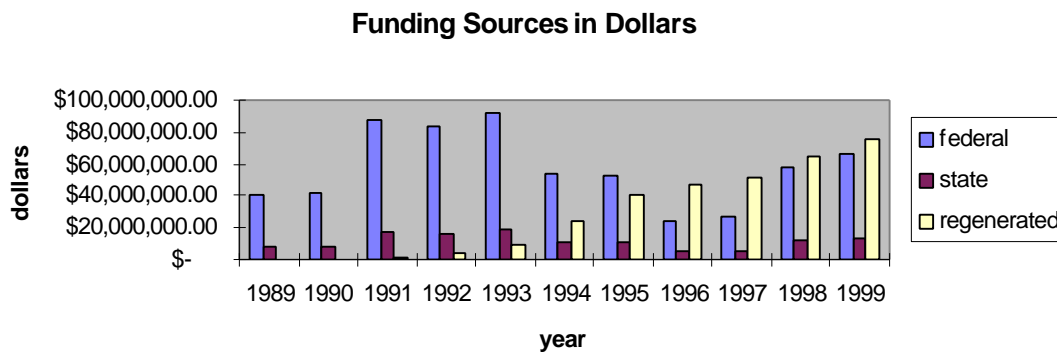
11. Automated Clearinghouse: Michigan has agreed to accept payment from the EPA through the Automated Clearinghouse system and has abided by cash draw rules.
12. Legal Certifications: The state of Michigan has provided all necessary certifications from the state Attorney General's office, which attest to its ability to implement the SRF and bind itself to the terms of the Capitalization Grant Agreement. The certification for the FY1999 capitalization grant was dated December 3, 1998.

## VI. SIGNIFICANT PROJECT ACCOMPLISHMENTS OF THE SRF

To date, Michigan's SRF has awarded \$1.076 billion in loans. Interest repayments from earlier awards are being held for possible repayment of state revenue match bonds for future issues. Principal payments from these loans and investment earnings have been building and will be used to supplement declining federal capital contributions. This strategy allows us to better maintain program expectations with the municipal, consulting, and contractor stakeholders.

Of the total amount loaned during FY1999, \$65,654,797 came from the EPA Capitalization Grant, \$13,131,940 came from the state match, \$41,214,811 came from principal and interest from outstanding loans, and \$34,519,263 came from investment earnings, and \$95,476 came from FY1998 carryover and released funds.

Over the lifetime of the Michigan SRF program, the dependence on federal dollars for capital funds has diminished to a point where the dollars capitalized through principal, interest, and investment exceeds those dollars received from the EPA Capitalization Grant. This shift from federal funds to SRF generated funds for financing SRF projects is a testament to the philosophy of the revolving fund concept. Michigan, through its efforts to maximize initial funding opportunities and in turn, loan those funds out, has created a viable revolving fund mechanism. The graph below shows how the infusion of funds generated from the SRF has increased over the life of the program to a point where they exceed federal Capitalization Grant dollars.



The interest rate for projects funded during the first five years was 2 percent. For FY1995-1998 the rate increased to 2.25 percent, and for FY1999 the rate was 2.5 percent.

**Chart 3** - Project Initiation of Operation Dates, demonstrates the projects that have actually commenced operation since the program started in chronological order.

To date, Michigan's SRF has gone to the market for eight issues. The most recent was on September 30, 1999 for \$249,750. These bonds are used to provide disbursement proceeds for project draws and are timed to cover a period running from 12 to 15 months at a time.

In selling the bond issue for the SRF and the DWRP in 1999, the State sought bond ratings from both Moody's Investor Services and Standard & Poors. The ratings on SRF bonds were rated Aaa & AA1, respectively, showing a high level of confidence in the financial integrity and administrative capability of the MDEQ and the MMBA.

## **VII. CONCLUSIONS**

Michigan's SRF program has matured into a well run, well received financing program. The state has been able to deliver its available funds in a manner that emphasizes consistency of environmental review, financial capability standards, as well as delivery of reimbursement for project costs. There have been 165 projects funded to date, delivering over \$1.076 billion in loans. The moneys which capitalize the SRF are now derived predominately from repayments and earnings on investments. The original intention of developing the SRF as a revolving, self-supporting fund is now being realized.

Staff of the Municipal Facilities Section have continued to effectively manage the SRF program for water pollution control, while proceeding with a successful DWRF program. Additional staff have been trained and integrated into the existing staff. The MFS staff are responsible for both DWRF and SRF projects, and work diligently to ensure that projects in both programs receive full attention. The MFS remains committed to customer service and through shared experiences and customer feedback, revisions and improvements to both programs are implemented on a periodic basis. We believe that the staff commitment to each program is the principal reason that Michigan's revolving fund programs will continue into the future with high visibility and success.

On November 3, 1999, the MDEQ and the MMBA sponsored a celebration of awarding over one billion in loans since the inception of the program.